Nos. 667-670

(6)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

WESLEY W. WEST, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

J. MARION WEST, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ESTATE OF J. M. WEST, DECEASED, JAMES M. WEST, JR., ET AL., EXECUTORS, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

JESSIE GERTRUDE WEST, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

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INDEX.

	Page
OPINIONS OF THE COURTS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
STATUTE INVOLVED	3
STATEMENT OF FACTS	4
ASSIGNMENT OF ERRORS	6
SUMMARY OF ARGUMENT	7
ARGUMENT:	
Point I. The economic effects of the transfer to Humble were those of a sale resulting in capital gain; they were not those of a lease resulting in ordinary income	8
Point II. The lack of any right of forfeiture or reverter is determinative of the nature of the transaction	12
Point III. A holding that a sale of land with a royalty retained amounts to a lease of the minerals will result in confusion and completely alters existing practices	16
Point IV. The Tax Court's determination that the transaction did not constitute a sale within the meaning of the capital gains provisions of the Revenue Act is not binding upon reviewing courts	17
CONCLUSION	18

CITATIONS.

CASES:

Amerada Petroleum Co. v. Doering, 93 F. (2d) 540	10
Badger Oil Co. v. Commissioner, 118 F. (2d) 791 (1941), certiorari denied 314 U. S. 634, rehearing denied 314 U. S. 712	9
Bingham, Trust u/w, v. Commissioner, 65 S. Ct. 1232	18
Burnet v. Harmel, 287 U. S. 103	8, 10, 11, 12, 13

Page

Burnet v. Logan, 283 U. S. 404 15
Canadian River Gas Co. v. Higgins, ——— F. (2d) ———, C. C. H. Standard Federal Tax Reporter, Par. 9450 15
Commissioner v. Crawford, 148 F. (2d) 776, certiorari granted Oct. 8, 1944 .....13, 14, 15
Commissioner v. Felix Oil Co., 144 F. (2d) 276.... 13
Commissioner v. Hopkinson, 126 F. (2d) 406..... 15
Commissioner v. Kirby Petroleum Co., 148 F. (2d) 80, certiorari granted May 21, 1944.....13, 14, 15
Danciger Oil & Refining Co. of Texas, et al v. Powell, et al, 154 S. W. (2d) 632 11
Freeman v. Magnolia Petroleum Co., 165 S. W. (2d) 111, rehearing denied October 26, 1942..... 10
Freeport Sulphur Co. v. American Sulphur Royalty Co., 6 S. W. (2d) 1039 11
Helvering v. Elbe Oil Land Development Co., 303 U. S. 372 8
A. B. Innis v. Commissioner, T. C. Dockets 2735, 2736, decided June 29, 1945, C. C. H. Dec. 14,667(M) 13
Loomis v. Gulf Oil Corp., 123 S. W. (2d) 501..... 11
Morgan v. Commissioner, 309 U. S. 78, opinion amended and rehearing denied 309 U. S. 626..... 11
Palmer v. Bender, 287 U. S. 551 8
Sauder v. Mid-Continent Petroleum Corp., 292 U. S. 272, rehearing denied 292 U. S. 613..... 10
Thomas v. Perkins, 301 U. S. 655 8
Williams Bar Dredging Co. v. Commissioner, T. C. Dockets 3284, 4074, decided June 30, 1945, C. C. H. Dec. 14,669(M) 13

STATUTES:

Revenue Act of 1938, c. 289, 52 Stat. 447; Sec. 117.. 3

MISCELLANEOUS:

Walker, Jr., The Nature of the Property Interests Created by an Oil and Gas Lease in Texas, 11 Texas Law Review, 401 (1933) 10

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OPINIONS OF THE COURTS BELOW.

The opinion of the Tax Court is found in 3 T.C. 431 (R. 236-275). The Commissioner prevailed upon the issue now in question. The opinion of the Circuit Court of Appeals

for the Fifth Circuit (R. 331-337) is reported in 150 F. (2d) 723. The Commissioner prevailed upon the issue now in question.[1]

JURISDICTION.

1. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, 43 Stat. 936, 28 U.S.C. Section 347(a).

2. The date of the judgments of the Circuit Court of Appeals for the Fifth Circuit herein sought to be reviewed is July 24, 1945, (R. 344-346) and the petitioners' petition for rehearing, filed on September 8, 1945, (R. 349-353) pursuant to an order of the Circuit Court of Appeals dated August 3, 1945, extending the time for filing such petition until September 11, 1945, (R. 348) was denied on September 18, 1945, (R. 353, 354).

QUESTIONS PRESENTED.

1. Whether the conveyance of the petitioners' lands under a general warranty deed and contract of December 28, 1938, including portions of the minerals thereunder constituted a sale of capital assets within the meaning of Section 117 of the Revenue Act of 1938, or whether the transaction was a sale of the surface of the land and the mere leasing of the minerals.

2. Whether the Tax Court's conclusion concerning the legal effect of the transaction and its interpretation and application of Section 117 of the Revenue Act of 1938 is final and binding upon review.

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[1] The proceedings involving the above entitled petitioners were consolidated in the Tax Court (R. 20), in the Circuit Court of Appeals (R. 324), and in this Court and only one record has been printed covering the consolidated cases *sub nom. Wesley W. West* v. *Commissioner of Internal Revenue*, pursuant to stipulation of counsel (R. 356).

STATUTE INVOLVED.

The Statute involved is Section 117 of the Revenue Act of 1938, c. 289, 52 Stat. 447.

"Sec. 117. CAPITAL GAINS AND LOSSES.

"(a) DEFINITIONS.—As used in this title—

* * * * *

"(4) LONG-TERM CAPITAL GAIN.—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

"(b) PERCENTAGE TAKEN INTO ACCOUNT. —In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * * * *

"50 per centum if the capital asset has been held for more than 24 months.

"(c) ALTERNATIVE TAXES.—

"(1) IN CASE OF NET LONG-TERM CAPITAL GAIN.—If for any taxable year a taxpayer (other than a corporation) derives a net long-term capital gain, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

"A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 30 per centum of the net long-term capital gain."

STATEMENT OF FACTS.

In December, 1938, the petitioners, and a certain charitable foundation not here involved,[2] were, and had been for more than two years, the owners of approximately 23,000 acres of land in Texas. On December 28, 1938, this land, together with certain improvements thereon, was conveyed by a warranty deed to the Humble Oil & Refining Company (herein called "Humble"). In the same deed the grantors also conveyed all the minerals underlying a certain 70.67 acres (of which the petitioners retained the surface estate) and the two hundred acre tract and improvements constituting the homestead of J. M. West and Jessie Gertrude West. (R. 238, 239). A portion of the minerals underlying the lands, more fully described below, was excepted from the conveyance. (R. 240, 241). Humble paid the petitioners $7,967,145.24[3] for the property.

The mineral interest excepted from the conveyance was described more particularly in a contemporaneous agreement entered into by the petitioners and Humble which was incorporated into the deed by reference (R. 238) and amounted to various percentages depending upon the locality and depth.[4] In the interest of simplicity we will refer to the petitioners' and Humble's respective interests

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[2] For purposes of convenience the grantors will be called "the petitioners" although the charitable foundation is not here involved and although J. M. West, one of the original grantors, is now dead.

[3] The total cash payment was $8,032,145.26 which included payments for the assignment of two leases upon other lands, which leases are not now in issue. It was stipulated below that $65,000 of the total payment should be allocated to the leases and the Tax Court made a finding in accordance with the stipulation (R. 257).

[4] 3/8 of the oil which might be produced from two portions of the land lying within two known oil fields from a depth of not more than 7500 feet; 1/4 of the oil produced from areas lying outside the two fields and from a depth not in excess of 7500 feet; 3/16 of the oil produced from all areas from a depth of more than 7500 feet; and other provisions with respect to dry gas, casing head gas, and other minerals (Ex. 2, R. 94, 95, 96 and R. 253).

in the minerals as 3/8 and 5/8. The contract provided that in the case of any of the portions of land conveyed by the petitioners subject to royalties retained by the petitioners' grantors,[5] the interest retained by the petitioners was to be reduced by that amount. (R. 243, 244).

The contract further included specific provisions for the development and operation of the petitioners' and Humble's jointly held mineral interests. Humble agreed to operate two drilling rigs in each of the two known fields until there was one well to each twenty acres, or to a greater extent if it were necessary to drill offset wells to prevent drainage. (R. 245, 246). It was provided that if oil should be discovered above or below the then existing horizons in the known fields or upon the unexplored areas, Humble would reasonably develop the same, and a standard for reasonable development was set forth. (R. 247, 248). Humble was not required to explore new horizons or the unprospected areas generally but the petitioners were given the right to request Humble to drill five test wells within cerain areas at any time after the expiration of five years after the development of the two known fields to the extent provided. (R. 248, 249, 250). The depth of the test wells was limited to 10,000 feet. (R. 252, 253). Neither the deed nor the contract contained any provision for the reversion of any part of the lands to the petitioners nor any provision for forfeiture, (R. 255), nor other limitations upon the estate conveyed to Humble.

In their respective income tax returns for 1938, the petitioners reported the profits deemed to have been realized upon the transaction with Humble as a long-term capital gain (gain from the sale of capital assets held more than

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[5] There were included in this category 28 tracts or portions of the tracts numbered 16 (R. 41), 25 (R. 44), 30 (R. 47), 31 (R. 47), 37 (R. 49), 38 (R. 49), 40 (R. 50), 41 (R. 50), 46 (R. 52), 59 (R. 56), 61 (R. 57), 63 (R. 57), 66 (R. 58), 69 (R. 59), 70 (R. 59), 71 (R. 60), 79 (R. 62), 81 (R. 63), 87 (R. 65), 90 (R. 66), 92 (R. 67), 98 (R. 69), 106 (R. 72), 107 (R. 73), 111 (R. 75), 112 (R. 75), 115 (R. 76) and 119 (R. 78).

two years[6]). In determining the profit a portion of the cost was allocated to the 3/8 interest retained.[7] (R. 258). The Commissioner asserted deficiencies on the theory the transaction was a sale of the surface and a lease of the minerals and that so much of the cash received by the petitioners as could be allocated[8] to the minerals and oil improvements constituted a cash bonus upon a lease upon which a depletion deduction was allowable and not a payment for capital assets. The portion of the cash payment which was allocated to the sale of the surface estate was treated as a payment upon the sale of capital assets. (R. 258, 259). The Tax Court sustained the Commissioner (R. 275)[9] and the Circuit Court of Appeals affirmed the Tax Court's decision. (R. 337).[10]

ASSIGNMENT OF ERRORS.

The Circuit Court of Appeals for the Fifth Circuit erred:

1. In determining that the transaction amounted to a lease of the minerals notwithstanding there was a sale of the surface of the land.

2. In determining that the tax liability arising from the transaction was not determined by the capital gains provisions of the Revenue Act.

3. In holding that there was substantial evidence to support the view of the Tax Court that the transaction amounted to a lease of the minerals and a sale of the surface.

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[6] It was stipulated that the land and minerals conveyed constituted capital assets (R. 30, 31).

[7] There is no dispute concerning the proper method of allocating cost between the minerals and the surface and the allocation of 5/8 of the mineral cost to the minerals transferred.

[8] No allocation of payments between surface and minerals was made by Humble and the petitioners. There is no dispute concerning the proper allocation for tax purposes if one is to be made. (R. 259.)

[9] Two judges dissenting. (R. 276-281.)

[10] One judge dissenting. (R. 337-344.)

4. In deciding, in substance, that the interpretation and effect given the conveyance by the Tax Court and the application thereto of Section 117 of the Revenue Act was binding upon the Circuit Court and not subject to review.

5. In holding, in effect, that the determination of the Tax Court that the transfer did not amount to a "sale" within the meaning of Section 117 of the Revenue Act of 1938 was a finding of fact that was binding upon the Circuit Court on review.

6. In affirming the decision of the Tax Court.

SUMMARY OF ARGUMENT.

The economic effects of the transfer in question were substantially the same as those which would have resulted if the transaction had been couched in terms of the sale of a portion of the underlying minerals. The Commissioner has recognized in the Tax Court that had this been the case, the transaction would be governed by the capital gains provisions. Depletion deductions are not properly allowable upon the proceeds of an outright transfer of mineral interests. Depletion allowances are granted to allow owners of mineral interests to recover their capital as it is depleted by production. The holding in these cases that the cash payment amounted to a bonus has the effect of allowing a depletion deduction upon a payment arising out of a transaction which differs materially in its economic consequences from a lease and which transaction results in an outright transfer of a 5/8 mineral interest. Depletion is accordingly allowed upon a payment which has no reference to present or future production of minerals in which the petitioners have retained an economic interest.

The tax treatment of a payment is determined with reference to the transaction giving rise to the payment. The payment here in question arises out of a transaction which had the outstanding characteristics of a sale in that it was a permanent transfer without any possibility of forfeiture or reversion. It should not, therefore, be treated as a bonus upon a lease.

It is a very common practice for landowners in oil producing areas to sell their property and retain a royalty. Such transactions have until now been considered capital transactions. A holding that a sale of land subject to a retained royalty amounts to a lease of the mineral interest will result in confusion and will have the effect of altering the existing practices with reference to the tax treatment of such transfers. Any such change will not necessarily benefit the revenue.

The Tax Court's determination that the transaction in question did not constitute a sale within the meaning of the capital gains provisions of the Revenue Act of 1938 is not binding upon appellate courts. The question is a clear-cut question of law which is open to review.

ARGUMENT.

I. The economic effects of the transfer to Humble were those of a sale resulting in capital gain; they were not those of a lease resulting in ordinary income.

The sale of oil and gas properties results in capital gain (or loss)[11] and the leasing of such properties for a cash bonus plus royalties results in ordinary income from which a depletion allowance is deductible.[12] The capital gain tax and the depletion allowance have quite different purposes; the capital gain tax is directed to the encouragement of alienation of property[13] by the owner, while the depletion allowance is intended to allow the owner of an economic interest in mineral producing property to regain his costs as production gradually reduces the value of his property.[14]

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[11] Helvering v. Elbe Oil Land Development Co., 303 U. S. 372 (1938).

[12] *Burnet* v. *Harmel*, 287 U. S. 103 (1932).

[13] *Burnet* v. *Harmel*, *supra*, p. 106.

[14] *Thomas* v. *Perkins*, 301 U. S. 655 (1937); *Palmer* v. *Bender*, 287 U. S. 551, 557, 558 (1933). "The allowance for depletion is intended to return to the owners of the oil reserve the loss of their

The provision in the revenue acts for the allowance of a depletion deduction does not have the effect of converting for tax purposes all transactions in oil and gas properties into leases. One may sell such property in the ordinary way (the surface and the minerals), or one may sell the minerals only, or a fraction of the minerals,[15] and all are capital transactions in which cost is returned through purchase price and not gradually through the depletion allowance on production. The Commissioner explicitly admitted in the Tax Court (R. 261) that a sale of a part of the minerals in place[16] would be governed by the capital gains provisions. Neither the Tax Court nor the Circuit Court of Appeals have suggested any other view.

The sale of 5/8 of the minerals in place differs in no substantial way from the sale by the petitioners of all the minerals with the exception of 3/8. In both cases it would be contemplated by the parties that the minerals would ultimately be produced.[17] In both cases the joint owners would necessarily make some plan or provision for the working of their joint interests.[18] In both cases the joint owners each

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capital which enters into the sale price of the oil produced. It deals with *income realized by production*. It has *no* application to *sales in whole or in part* of the capital investment, the oil reserve itself." *Badger Oil Co.* v. *Commissioner*, 118 F. (2d) 791, 793 (C. C. A. 5th (1941), certiorari denied 314 U. S. 634 (1941), rehearing denied 314 U. S. 712 (1941).

[15] It is well established that in Texas and elsewhere a landowner may sell the surface only, the mineral estate only or a portion of the mineral estate only. (R. 261.) This was recognized by the Tax Court (R. 265) and by the Circuit Court of Appeals. (R. 332.)

[16] Also a part or all of a royalty interest.

[17] A purchaser of a 5/8 of the minerals in place could have no other possible reason for making the purchase.

[18] If the purchaser of the partial mineral interest agrees as a part of the purchase price to carry on certain developmental work instead of paying a larger amount of cash, the transaction is still a sale. It may be that the 3/8 of the value of the work carried on by Humble each year is an additional payment of purchase price

could allow his property to lie undeveloped indefinitely without impairing any of his rights and in both cases the seller has irrevocably parted with a portion of his property and no termination or forfeiture will ever result in its return to him. This is made entirely clear if we consider what the situation would be if the property had been owned by a third party, X, and Humble had purchased 5/8 of the minerals from X and the petitioners had purchased 3/8. Humble and the petitioners then would ultimately have to agree upon some method of operating their joint interests. If Humble undertook the operation, it could not be said that the petitioners had leased 5/8 of the minerals to Humble. The fact that Humble's grantor was not X but the petitioners cannot alter the underlying theory.

The economic effects of a leasing arrangement are quite different from those described above. The lessee of mineral interests receives the right to exploit the land for only a limited period of time.[19] Any minerals left in the ground upon the termination of the lease belong entirely to the lessor.[20] If the lessee fails to carry on reasonable development and exploration activities, his lease would terminate and the unmined minerals revert to the lessor.[21]

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resulting in capital gain. But that question is not here presented since the transaction took place at the end of 1938, the only year involved.

[19] *Burnet* v. *Harmel*, *supra*, p. 107.

[20] *Burnet* v. *Harmel*, *supra*, p. 111.

[21] This is true irrespective of any specific provision for exploration and development. A mineral lease is said to carry an implied covenant of development. *Sauder* v. *Mid-Continent Petroleum Corp.*, 292 U. S. 272 (1934), rehearing denied 292 U. S. 613 (1934), which was a suit for the cancellation of a mineral lease in Kansas upon that portion of leased land upon which the lessee had failed to carry out reasonable development; *Amerada Petroleum Co.* v. *Doering*, 93 F. (2d) 540 (C. C. A. 5th, 1937); A. W. Walker, Jr., The Nature of the Property Interests Created by an Oil and Gas Lease in Texas, 11 Texas Law Review, pp. 401, 402 (1933); *Freeman* v. *Magnolia Petroleum Co.*, 165 S. W. (2d) 111 (1942), rehearing denied Oct. 26, 1942. We know of no instance in which a

The respective rights[22] of Humble and the petitioners under this transaction were completely different from those existing in the lessee and the lessor of the ordinary oil and gas lease. Humble did not acquire the right to exploit the land for a *limited* length of time but *forever*. There is no possibility that unmined minerals will ever revert to the petitioners. Humble could, at the risk of a suit for damages, fail to carry out any development whatever, and there could be no termination or forfeiture of its right to do so in the future. Humble could engage in the stipulated develop-

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general covenant of development and operation has been implied in the case of a transfer of a fee interest with a resultant forfeiture of or termination of the purchaser's estate upon a breach of such a covenant. The problem is considered generally in *Danciger Oil & Refining Co. of Texas, et al* v. *Powell, et al*, 154 S. W. (2d) 632, 137 Tex. 484 (1941); *Loomis* v. *Gulf Oil Corporation*, 123 S. W. (2d) 501 (Texas, 1938), rehearing denied Jan. 13, 1938. In the one case we know of in which there was a conveyance of a fee and any covenant was implied by the court, the implied covenant was an extremely limited one arising from the express stipulation of the parties themselves. The case involves the sale of sulphur lands and a part of the stipulated consideration for the sale was the erection of one sulphur plant. Several sulphur plants were erected, operated for awhile and then shut down. The court held that the parties must have contemplated the continued operation of *one* plant (not all the plants) and granted damages. There was no suggestion that there could be any forfeiture of any interest by the purchaser upon the failure to operate even the one plant. *Freeport Sulphur Co.* v. *American Sulphur Royalty Co.*, 6 S. W. (2d) 1039 (Texas, 1928).

[22] These rights are determined by local law. It is immaterial for tax purposes by what name local law designates the relationship of the parties (*Morgan* v. *Commissioner*, 309 U. S. 78 (1940), opinion amended and rehearing denied, 309 U. S. 626 (1940)), but the substantive property rights of the parties as fixed by local law are binding upon the Federal Courts for purposes of taxation (*Burnet* v. *Harmel*, *supra*). For example, it is immaterial that Texas law would designate Humble's interest as a "fee estate," but it is material if under Texas law the rights and duties of the parties to this transaction are in marked contrast to those of a lessor and lessee under the law of Texas and elsewhere.

ment work[23] and then cease further activities for as long as it wished without any suit for damages or any danger that it would lose its rights to continue development when it suited its purposes to do so. After completing the minimum stipulated development provisions, Humble could fail to explore the unexplored areas or the sands lying above or below the present producing horizons without risk of damages, forfeiture or termination. Humble in this transaction gained far greater rights than it would have acquired under a lease and the petitioners transferred all the important incidents of ownership which would be transferred on a sale.

II. The lack of any right of forfeiture or reverter is determinative of the nature of the transaction.

While this is a case of first impression upon the exact question presented, the principles of law upon which any decision must be based have frequently been considered in cases dealing with the closely related question whether taxpayers acquiring or retaining various interests in mineral property have retained a depletable interest. The basic theory was clearly developed in *Burnet* v. *Harmel*.[24] In that case this Court analogized the cash bonus paid upon the granting of a lease (with a royalty retained) to an unusually large rent in the first year of a lease, pointing out that its size did not alter its basic character as rent. The Court described the essential characteristics of a mineral lease which distinguishes it from a sale of minerals in place; (1) that the lessee acquires and makes payment for the "privilege of exploiting the land for the production of oil and gas for a prescribed period";[25] and (2) that all the

[23] Which fall far short of the development work which would be required under the covenant implied under the ordinary oil and gas lease as pointed out by Judge Disney. (R. 279.)

[24] *Supra.*

[25] *Burnet* v. *Harmel, supra*, pp. 107, 111.

minerals not abstracted, "will remain the property of the lessor upon termination of the lease."[26]

When the transaction possesses these two determinative characteristics, it is regarded as a lease and all payments, including the bonus payment, made are considered similar to rent, taxable as ordinary income.[27] When the transaction has neither of these characteristics, as in the present case, any payments made thereunder cannot be considered rental income upon which a depletion deduction is allowable. The depletion allowance is granted only upon the theory that the landowner has retained some sort of economic interest in the minerals which is being (or is to be) depleted by production. The petitioners have retained no economic interest in the property sold to Humble for which they received the cash payment here involved. As Humble produces oil, 5/8 of the oil produced belong to it and 3/8 belong to the petitioners; the petitioners suffer no depletion of their interest by reason of the production of Humble's 5/8, they receive everything they own and lose nothing because Humble takes its 5/8 interest; the treatment of the cash payment, which was and could have been made only for Humble's 5/8 interest, as a bonus upon which depletion is allowable rather than as the purchase price, has the effect of giving the petitioners a depletion allowance upon the 5/8 of the minerals in which they have no economic interest whatever.

In several recent cases in the Circuit Court of Appeals[28] and the Tax Court[29] (which involved leases in which the les-

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[26] *Burnet* v. *Harmel*, p. 111.

[27] Because the lease is of a mineral property, the rent is subject to the depletion allowance.

[28] *Commissioner* v. *Felix Oil Co.*, 144 F. (2d) 276 (C. C. A. 9th, 1944); *Commissioner* v. *Kirby Petroleum Co.*, 148 F. (2d) 80 (C. C. A. 5th, 1945), certiorari granted May 21, 1944; *Commissioner* v. *Crawford*, 148 F. (2d) 776 (C. C. A. 9th, 1945), certiorari granted Oct. 8, 1944.

[29] *A. B. Innis* v. *Commissioner*, T. C. Dockets 2735, 2736, decided June 29, 1945, C. C. H. Dec. 14,667(M); and *Williams Bar Dredging Co.* v. *Commissioner*, T. C. Dockets 3284, 4074, decided June 30, 1945, C. C. H. Dec. 14,669(M).

sor stipulated for a percentage of the net proceeds of the operation of the property) the Commissioner has taken a position exactly contrary to his view here. He has urged in the Circuit Court of Appeals that in these cases there was an outright transfer of the mineral interest and that the lessors retained no economic interest in the minerals by reason of their right to share in the net profits of the lessees. The Tax Court and the Circuit Court of Appeals for the Ninth Circuit have held that payments under the net-profit type of transaction are to be treated as rental income upon which the depletion allowance is deductible. They have distinguished the leasing transactions involved in those cases from a complete transfer of a portion of the mineral interest upon the ground that the lessors retained an economic interest in all the minerals by reason of their retention of rights of reverter and forfeiture.[30] As pointed out above, the petitioners here have retained no economic interest in all the minerals. They can never under any circumstances regain or assert a right to the 5/8 of the minerals conveyed to Humble whether the minerals are produced or allowed to remain in the ground indefinitely. The petitioner's capital investment in these minerals is gone.

In the *Kirby* and *Crawford* cases, the Commissioner has urged that the lessors failed to retain an economic interest in the minerals in place measured by the net profits. He has sought to deny the lessors a depletion deduction upon their share of net profits upon the ground that net profits do not constitute gross income from the property upon which the depletion deduction is based.[31] The Commissioner has not, however, taken the position in these cases that the share

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[30] The Circuit Court of Appeals for the Fifth Circuit came to the opposite conclusion, one judge dissenting in *Commissioner* v. *Kirby Petroleum Co., supra.* Certiorari was granted in this case, presumably because of the conflict with the decisions of the Circuit Court of Appeals for the Ninth Circuit.

[31] Commissioner's brief in this Court in *Kirby Petroleum Co.* v. *Commissioner,* p. 8, *et passim.*

of net profits constitute the proceeds of a sale[32] of capital assets since he treats these payments as ordinary income.[33] If these payments are ordinary income, it must only be so because they arise out of a transaction which does not have the characteristics of a sale. As pointed out by Judge Learned Hand[34] "... payment never of itself creates a tax. It becomes taxable only by virtue of the nexus of facts of which it is a part, and which constitutes the legal transaction. It is the transaction which determines the character of the tax: i.e., whether it is to be imposed upon income, or upon capital gain ..." The transactions involved in the *Kirby* and *Crawford* cases, unlike that here in question, bore the characteristics of leases because the transferors retained a right of forfeiture and a right of reverter in unmined minerals. Accordingly, the payments involved in the *Kirby* and *Crawford* cases might reasonably be taxed as ordinary income.

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[32] A sale is none the less a sale under the revenue laws because the purchase price is paid in installments in an unlimited total amount and over an unlimited period of time. *Burnet* v. *Logan*, 283 U. S. 404 (1931); *Commissioner* v. *Hopkinson*, 126 F. (2d) 406 (C. C. A. 2d, 1942). In the first case the payments were for an unlimited period of time, no maximum amount was fixed and, they were measured by the ore mined by the purchaser. In the second case similar payments upon the sale of patents were measured by a certain sum upon each article manufactured under the transferred patents and a percentage of any payments received by the buyer from licensing the patents to others.

[33] Commissioner's brief in *Kirby Petroleum Co.* v. *Commissioner*, p. 25, *et seq.*

[34] In his dissenting opinion in *Canadian River Gas Co.* v. *Higgins*, ——— F. (2d) ——— (C. C. A. 2nd, 1945), decided November 9, 1945, not yet officially reported and found in Vol. IV, 1945 C. C. H. Standard Federal Tax Reporter, Par. 9450.

III. A holding that a sale of land with a royalty retained amounts to a lease of the minerals will result in confusion and completely alters existing practices.

The Commissioner may contend here, as he in effect contended in the Circuit Court of Appeals (Government's brief, in the Circuit Court of Appeals, p. 13), that there can never be a sale for purposes of the capital gains provisions if the seller sells less than the full mineral interest (i.e. retains a royalty). If this is the law, it represents a revolutionary change in what has been the understanding of myriad taxpayers in mineral producing areas. It is the customary practice in these areas for landowners to sell their land retaining a royalty interest.[35] These have been considered sales by them both under the local law and for purposes of computing their taxes. So far as we have been able to ascertain, the present case is the first instance in the history of the income tax that the Commissioner has taken the view that a sale of land subject to a retained royalty amounts to a lease.

If the present transaction is held to be a lease for tax purposes, many taxpayers will have computed their taxes incorrectly[36] and many claims for refund and deficiency assessments will unquestionably result. There is no clear general advantage to the revenue[37] in determining that

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[35] The reason for this custom is the difficulty of achieving a price fair to buyer and seller when it is impossible to have any very accurate idea of the amount of minerals present, if any. The royalty device ameliorates the risks of both buyer and seller that too much or too little is being paid. The prevalence of this custom is illustrated by the fact that in this very transaction the land conveyed included 28 tracts of land which had been purchased by the petitioners subject to royalties retained by former owners. See footnote 5 above.

[36] Some will have overpaid, others will have underpaid.

[37] The advantage or disadvantage to the Government over a period of years will depend upon the rates applicable to capital gains and depletion, the size and structure of the income of buyers and sellers and a number of other factors.

sales with royalties retained are leases and such a determination is contrary to the basic theory underlying the depletion provisions and the cognate capital gains provisions. These two considerations would argue strongly against upsetting a practice of long-standing and introducing confusion into a field of the tax law where none has existed before.

IV. The Tax Court's determination that the transaction did not constitute a sale within the meaning of the capital gains provisions of the Revenue Act is not binding upon reviewing courts.

It is somewhat difficult to ascertain from a reading of the Circuit Court's opinion the extent to which it thought itself bound by the conclusion of the Tax Court that the transaction did not constitute a sale within the meaning of Section 117 of the Revenue Act of 1938. In the latter part of the opinion (R. 336, 337), however, emphasis is laid upon what the Circuit Court felt was a limitation upon its jurisdiction. It apparently took the view that the Tax Court's conclusion that the transaction did not amount to a sale was a factual determination of the sort not open to review except upon the ground of no substantial supporting evidence.[38]

The Tax Court in reaching this conclusion was not drawing factual inferences, the basic facts are undisputed. It was placing the transaction in one legal category rather than another by a consideration of the rights and duties of the parties. Furthermore, this orthodox judicial function was carried on by the Tax Court with reference to the words employed in the applicable revenue act. Its conclusion was not that there was no sale for purposes of the law of Texas

[38] If the determination were of such a factual character, there is here no substantial evidence to support the conclusion. The evidence, consisting principally of two documents, the deed and the contract, lends no support to the view that the transaction was a lease of the minerals.

or for any purpose but that there was no sale within the meaning of Section 117 of the Revenue Act of 1938. Such a determination involves a "clear cut" question of law, "decision of which by the Tax Court does not foreclose . . . appellate courts"[39] upon review.

The Circuit Court of Appeals accordingly misunderstood the limits upon its own jurisdiction when it treated the Tax Court's determination that there was no sale as one not subject to review upon appeal.

CONCLUSION.

In view of the foregoing, it is submitted that the petition for a writ of certiorari should be granted and the decision of the circuit Court of Appeals should be reversed.

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[39] *Trust u/w Mary Lily (Flagler) Bingham* v. *Commissioner*, 65 S. Ct. 1232, 1235 (1945).